GRAFTON GROUP LIMITED

ANNUAL REPORT FOR YEAR ENDED JANUARY 31, 1976

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ANNUAL MEETING

The Annual Meeting of Shareholders will be held at 11:30 a.m., May 27th, 1976 in Toronto in the Auditorium at 9 Sunlight Park Road.

ASSEMBLÉE ANNUELLE

L'assemblée annuelle des actionnaires aura lieu à 11 heures et demie de l'avant-midi, le 27 mai 1976, à Toronto dans l'auditorium à 9 Sunlight Park Road.

RAPPORT ANNUEL

Si vous désirez recevoir un exemplaire en français du rapport annuel du Groupe Grafton Limitée, veuillez vous adresser au service de la trésorerie, Le Groupe Grafton Limitée, 9 Sunlight Park Road, Toronto, Ontario.

Financial Highlights

	Year Ended January 31 1976	1975	% Change
Sales			
Retail Division			
Stores	$ 28,771,000	$ 21,915,000	+ 31.3
Licensed Woolco Departments	69,971,000	56,931,000	+ 22.9
Total Apparel	98,742,000	78,846,000	+ 25.2
Footwear (6 months in 1975)	29,359,000	15,285,000	
	128,101,000	94,131,000	+ 36.1
Homefurnishings Division	11,147,000	10,458,000	+ 6.6
	139,248,000	104,589,000	+ 33.1
Income from operations before depreciation, interest and other items	19,726,000	13,389,000	+ 47.3
Income from investments	611,000	341,000	+ 79.2
Depreciation and interest	3,140,000	2,490,000	+ 26.1
Other items	142,000	430,000	− 67.0
Net income	8,531,000	5,180,000	+ 64.7
Percentage of net income to sales	6.13	4.95	
Earnings per common share			
Basic	$4.51	$2.74	+ 64.6
Fully diluted	$4.22	$2.67	+ 58.0
*Dividends paid per common share	$ .60	$ .51	+ 17.6
Dividends paid as a percentage of net income	13.3%	18.6%	
Working capital	$ 19,848,000	$ 14,711,000	+ 34.9
Current ratio	2.1:1	1.9:1	
Earnings as a percentage of shareholders' equity	32.4	27.5	
Shareholders' equity	$ 26,281,000	$ 18,813,000	+ 39.7

*Dividends from October 14, 1975 are restrained by the Anti-inflation Act.

Board of Directors and Officers

CHARLES A. CADIEUX, C.M., K.G.C.H.S., *Retired Retail Executive*	Toronto
*G. RICHARD CHATER, *President, the Company*	Campbellville
BRIG.-GEN. W. PRESTON GILBRIDE, C.B.E., D.S.O., E.D., LL.D., *Chairman, the Company*	Toronto
WILLIAM A. HEASLIP, *Executive Vice President, the Company*	Milton
WILLIAM F. JAMES, Ph.D., *Consulting Geologist*	Toronto
*JAMES W. McCUTCHEON, Q.C., *Partner, Shibley, Righton & McCutcheon*	Toronto
STEWART PHILP, *Retired President of a Subsidiary*	Hamilton
*JOHN B. RIDLEY, *Retired Investment Dealer*	Toronto
SAM FOSTER ROSS, Q.C., *Partner, Ross & McBride*	Dundas
*GEORGE A. REYNOLDS, C.A., *Vice President Finance, Secretary and Treasurer*	Thornhill
T. EDWARD TOPPING, *President, Grafton-Fraser Limited*	Stouffville
*DAVID B. WELDON, *Chairman of the Board, Midland Doherty Limited*	Toronto
DOUGLAS C. WOOLLEY, Q.C., *Partner, Woolley, Hames, Dale & Dingwall*	Toronto
THOMAS R. YOUNG, *President, Toby Industries Limited*	Toronto

**Audit Committee*

Officers

W. P. GILBRIDE, *Chairman*

G. R. CHATER, *President*

W. A. HEASLIP, *Executive Vice President*

G. A. REYNOLDS, C.A., *Vice President Finance, Secretary and Treasurer*

Transfer Agent and Registrar

GUARANTY TRUST COMPANY OF CANADA

Montreal, Toronto, Winnipeg, Regina, Calgary, Vancouver

Head Office

9 SUNLIGHT PARK ROAD, TORONTO, M4M 3G1

Auditors

THORNE RIDDELL & CO., TORONTO

Stock Exchange Listings

GRAFTON GROUP LIMITED COMMON SHARES
Toronto Stock Exchange
Montreal Stock Exchange

MAHER SHOES LIMITED PREFERENCE SHARES
Toronto Stock Exchange

Directors' Report to the Shareholders

The Group enjoyed a good year, especially in the last half and final Christmas quarter. This is the 38th consecutive quarter in which our earnings have increased, an average in excess of 25%. Our financial position has also improved absolutely and comparatively, as the distortions of the large mid-year 1974 acquisition fall into a more clear perspective. Each of the three operating subsidiaries significantly improved its performance over the previous year in spite of market conditions. The earnings from our joint venture investment in Forsyth Trading Company Limited were up substantially from a very good base to make the results unanimous.

Our top management has been preoccupied since October 14, 1975 in endeavouring to comprehend, understand and conform to the Anti-Inflation Board guidelines since the initial pronouncement and subsequent releases of information come forth. We are as concerned about the impact of unbridled inflation on our society as anyone, and are committed to do whatever is possible on our part to achieve a degree of moderation. Our estimate of the regulation's impact on the next fiscal year is that we must strive to achieve a large sales increase in order to realize a much more modest earnings increase. Our plans are now reasonably well developed to accomplish the maximum possible incremental earnings under the guidelines.

In regard to dividends, it has been our policy to pay out approximately 20% of our earnings with the ambition to increase this percentage gradually as the company matures but in a conservative manner, taking into account the reasonable liquidity of our balance sheet. The A.I.B. guidelines will limit us to paying out 68¢ per share between October 14, 1975 and October 14, 1976, or 15.5% of last year's earnings. We believe this is most unfair to our shareholders, as many of our competitors have a base year of three times our percentage.

The outlook for the current year is likely to be one of consumer restraint and highly increased price competition. Our sales plan is ambitious but we believe we have a highly skilled and dedicated organization that will continue to achieve the best possible results.

For our long term future we have stepped up our vigilance in regard to quality control to build our clientele and out of respect for our responsibility to our customers, as is described in the Grafton-Fraser report.

The preliminary results from our subsidiaries indicate that at the end of the first quarter we are exactly on plan.

We most sincerely appreciate the efforts and accomplishments of all members of the Grafton Group and the loyalty and co-operation of customers, suppliers, developers and associates.

Submitted on behalf of the Board

G. R. Chater
President
April 15, 1976

Officers and Executives of Subsidiaries

GRAFTON-FRASER LIMITED

G. R. CHATER, *Chairman and Chief Executive Officer*

T. E. TOPPING, *President*

J. B. COUTTS, *Senior Vice President*

A. L. LUCAS, *Senior Vice President*

G. A. REYNOLDS, C.A., *Senior Vice President and Secretary*

E. C. FREDERICK, *Vice President*

J. R. WALKER, *Vice President*

S. A. LINDSAY, C.A., *Vice President and Treasurer*

W. J. SMITH, *Vice President*

R. M. HANNAH, C.A., *Controller*

H. SANDERS, *Administrator Public Relations and Personnel*

MAHER SHOES LIMITED

T. P. WILSON, *President*

J. W. REID, *President of a Subsidiary*

J. R. GILLIES, C.A., *Vice President and Treasurer*

L. D. PHILLIPS, *Vice President*

R. C. WILSON, *Vice President*

G. F. TRAVELLE, *Secretary*

L. GINSBERG, C.A., *Comptroller*

TOBY INDUSTRIES LIMITED

T. R. YOUNG, *President*

J. LOEB, *Vice President, J. B. McGregor Division*

D. P. WORSNOP, C.A., *Controller*

GRAFTON REALTY COMPANY, LIMITED

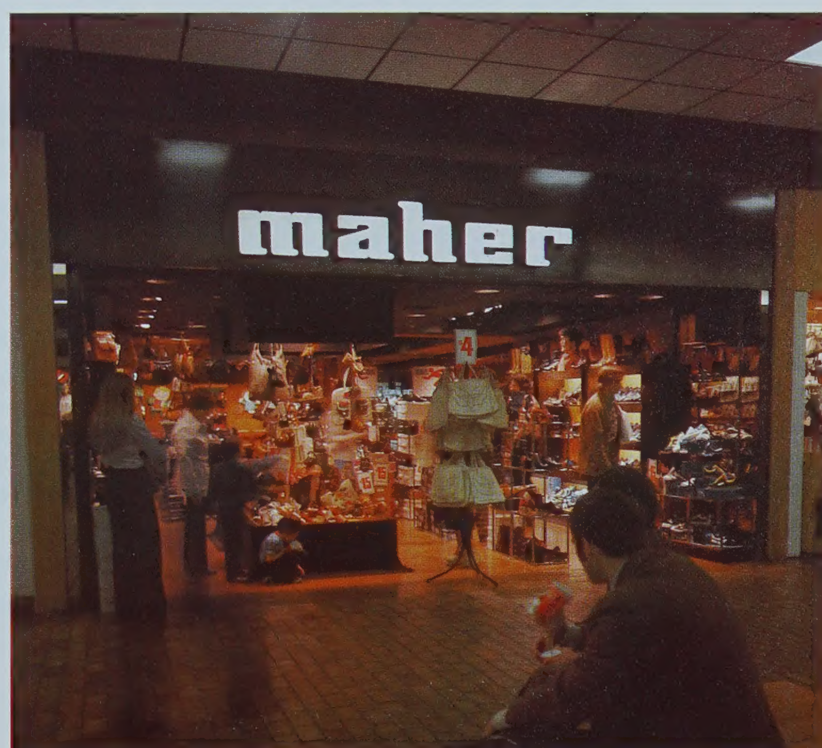
W. A. HEASLIP, *President*

MRS. J. A. LAWSON, *Assistant Secretary*

Store Photographs

Jack Fraser, Jack's and The Loft Store in the Sherway Gardens Shopping Centre, Toronto, Ont.

A section of the Menswear Department in the recently opened Woolco Department Store, Thorncliffe Market Place, Toronto, Ont.



Afternoon activity in the Maher Shoe Store, Greater Hamilton Centre, Hamilton, Ontario.

GRAFTON-FRASER LIMITED T. E. Topping, President

The results produced by company operated stores and leased departments in 1976 are both gratifying and indicative of our future potential. Both divisions added substantial increases to their 1975 sales volumes, but more importantly they also exceeded the sales targets set by management in a most competitive environment.

Several significant factors contributed to the overall improvement in performance. More seasoned executives, buyers and supervisors — stronger advertising — better warehousing — improved personnel training — have all made their contributions.

While seven new Woolco leased departments expanded our national coverage, the real growth came from well established departments. Great gains were made by departments in both the Eastern and Western sections of the country.

Nine Jack Fraser stores were added, of which eight carried Ladies Sportswear and several introduced the new "Jacks" Jean Department. Once again, older well established stores, many of which were recently renovated, made the major contribution to our growth.

We have a substantial expansion program in both divisions for 1976 — with seven Woolco departments and eleven Jack Fraser stores. The sales performance of the four stores opened to date in 1976 is extremely gratifying. There will be a larger than usual number of closings in the Fraser Division as leases expire in strip and downtown locations in 1976. The stores do not lend themselves physically or financially to extending their leases.

In 1976 we will begin a most serious effort to implement higher standards of quality control with all our vendors. This is a dedicated and long term commitment on our part to guarantee our customers the highest quality product in design, material and workmanship, regardless of the country of origin. We have retained the services of an experienced fabric technician to implement this program and to work closely with our buying executives.

Based on the strength and added experience of our buying team and store management, plus the opportunity to expand in many untapped regions, we have every reason for optimism in 1976.

MAHER SHOES LIMITED T. P. Wilson, President

Maher sales increased a further 7% during 1975, with net income returning to more acceptable levels as a result of this gradual development. Key operating statistics showed progressive improvement.

Sales increased 17.9% from continuing stores and sales productivity per square foot increased 17%. These increases were a result of strong performances in the two largest areas of activity — the western division, which enjoyed another outstanding year, and the continuing improvement in the large Maher division.

The operating year of 1975 was characterized by opening 14 new stores and closing 28 stores. Some of the sales impact of these close-outs was transferred to the Barcley-Lanes partnership, a non-consolidated investment.

Increasing attention was focused during the year upon the control of debt levels and special programs designed to improve inventory turnover in each division. We expect further improvement in the coming year, as we continue to strengthen the quality of our operations.

Ten to twelve new stores will be opened in 1976, and we are continually seeking additional opportunities to further enhance our profit and long term corporate goals.

We look forward with confidence to a good year for the company in 1976 given a reasonable continuation of the present atmosphere in consumer spending.

TOBY INDUSTRIES LIMITED T. R. Young, President

1975 was better than anticipated for Toby Industries. The year began with very soft market conditions and reasonably high inventories, but finished with a strong orders on hand position and inventories much more in line with sales. The Toby Division had an encouraging year with greatly improved profit contribution from slightly increased sales.

The subtle change in the product mix away from imports, produced a more profitable sales pattern to go with improved material and labour utilization. The belt-tightening performed at the end of 1974 and carried through 1975 created a more efficient operation and made the results much more rewarding.

In the second half of 1976, we are introducing Bed Comforters to our product line, which will complement our present bedspread business and produce increased sales volume. The new equipment is now installed and full production is expected by mid year.

The James B. McGregor Division ended 1975 with the strongest order position in its history. After a rather slow first six months, business accelerated so quickly that some problems were encountered in meeting the demand. Difficulties in both acquiring and manufacturing goods which arose in the Fall season, are now under control.

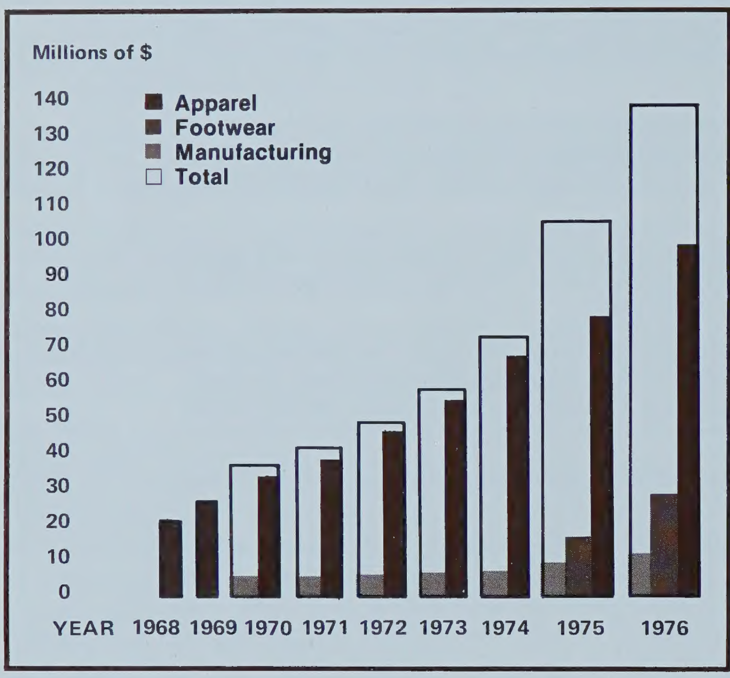
The introduction of a new computerized system of order in-put and inventory control will improve the preparation and delivery of goods to our customers.

The Home Furnishings Division is looking toward 1976 with restrained optimism and the expectation of both improved sales and profits but in compliance with the controls being placed on it by the Government.

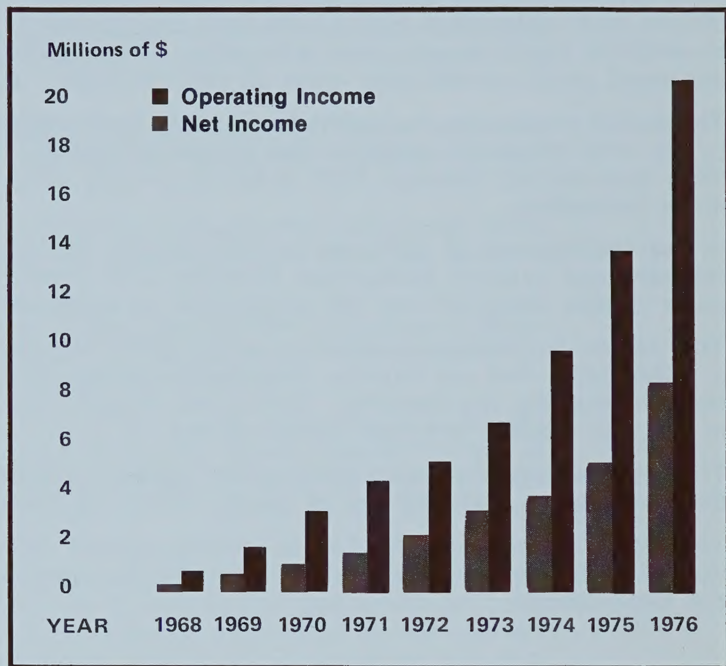
FINANCIAL ANALYSIS G. A. Reynolds, Vice President, Finance

Net income for the year rose to $8,531,000 from $5,180,000 or 64% while sales increased to $139,248,000 from $104,589,000 or 33%. Dividends disbursed were increased on an annualized basis from $.51 per common share to $.60 per share and the quarterly dividend payable June 15, 1976 has been raised to 17¢ from 15¢. Working capital amounted to $19,848,000, an increase of $5,137,000 or 35% and the current ratio improved to 2.1 to 1. Total year end inventory turnover increased to 5.7 times from 4.4 with the retail division inventory turnover going up to 5.9 from 4.6. Long term debt decreased $1,257,000 or 10% and the interest coverage available on this debt was 15.8 times. The long term debt to equity ratio is .45 to 1, as compared with .65 to 1. The excess of cost of shares over book value (goodwill) is being amortized over 40 years and $142,000 per year is being charged to after tax income. The market value of the listed marketable securities increased by $582,000 during the year and is now in excess of the original cost of $997,000 and an adjusted cost carrying value of $763,000. The equity income from Forsyth Trading Company Limited in two years has amounted to 85% of the original investment as that company continues to expand. Store productivity increased in Apparel Stores to $98.2 per sq. ft. from $86.5 and in Footwear Stores to $79.6 per sq. ft. from $67.8.

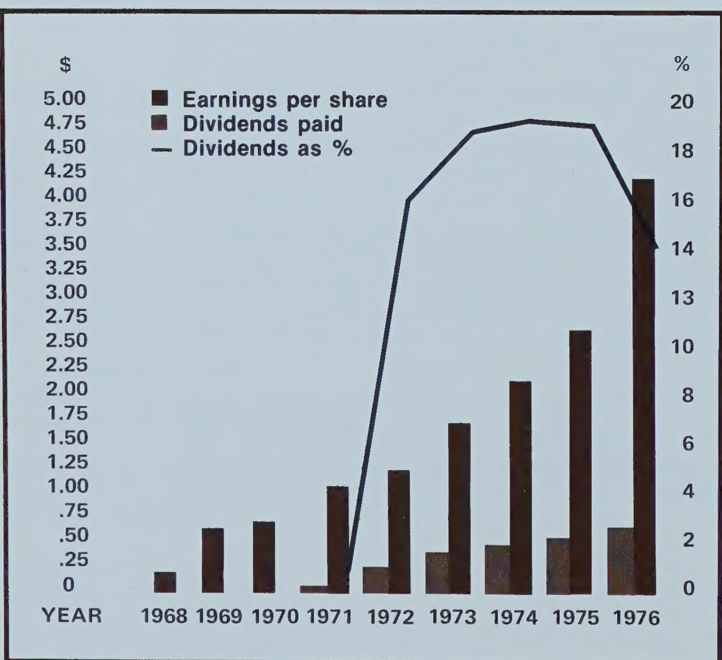
The company's apparent excess revenue during the past year was created prior to the introduction of the Anti-Inflation Act on October 14, 1975 and, therefore, the Act has had little effect on the year's income. While many aspects of the Act are as yet unclear, undoubtedly the profit growth during the next year will be limited. The restraint on dividends will reduce our payout ratio abnormally and further improve our liquidity next year.



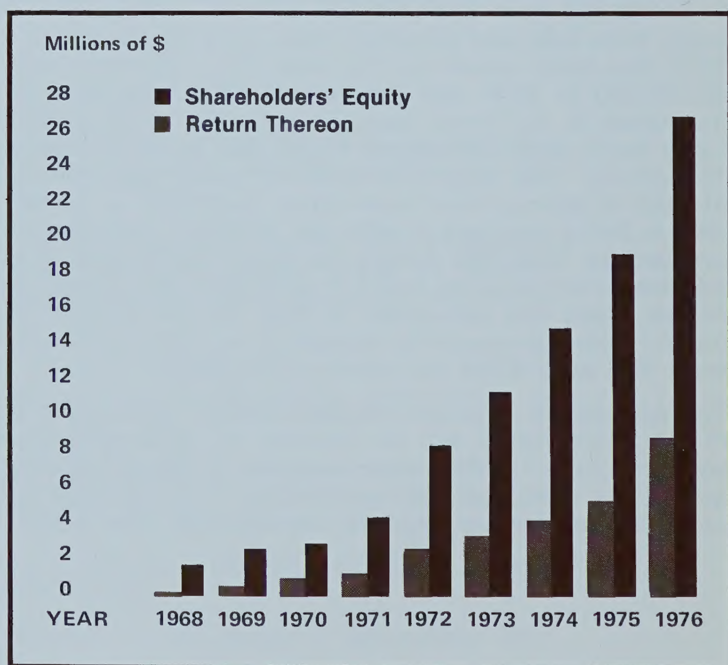
Sales



Operating and Net Income



Dividends And Earnings Per Share



Shareholders' Equity and Return Thereon

Consolidated Statements of Income and Retained Earnings

GRAFTON GROUP LIMITED
and subsidiary companies

	Year Ended January 31, 1976	1975
INCOME		
Sales		
Retail	$128,101,000	$ 94,131,000
Manufacturing	11,147,000	10,458,000
	139,248,000	104,589,000
Cost of sales and expenses other than undernoted	119,522,000	91,200,000
	19,726,000	13,389,000
Income from investments	611,000	341,000
Gain on sale of fixed assets		200,000
Income before taking into account the undernoted items	20,337,000	13,930,000
Depreciation	1,320,000	945,000
Interest on long term debt	1,144,000	764,000
Other interest	676,000	781,000
Amortization of excess of cost of shares over underlying book value of subsidiary at date of acquisition	142,000	71,000
Provision for decline in value of marketable securities and investments		359,000
	3,282,000	2,920,000
Income before income taxes and minority shareholders' interest	17,055,000	11,010,000
Income taxes	8,427,000	5,763,000
Income before minority shareholders' interest	8,628,000	5,247,000
Preference share dividends paid to minority shareholders of subsidiary companies	97,000	67,000
NET INCOME FOR THE YEAR	$ 8,531,000	$ 5,180,000
EARNINGS PER SHARE (note 7)		
Basic	$4.51	$2.74
Fully diluted	$4.22	$2.67

RETAINED EARNINGS		
BALANCE AT BEGINNING OF YEAR	$ 11,586,000	$ 7,369,000
Net income for the year	8,531,000	5,180,000
	20,117,000	12,549,000
Dividends on common shares	1,135,000	963,000
BALANCE AT END OF YEAR	$ 18,982,000	$ 11,586,000

Consolidated Balance Sheet

GRAFTON GROUP LIMITED
(Incorporated under the laws of Ontario)
and subsidiary companies

	January 31, 1976	1975
ASSETS		
CURRENT ASSETS		
Cash and bank deposit receipts	$ 8,391,000	$ 3,112,000
Accounts receivable	4,445,000	4,192,000
Marketable securities, at the lower of cost and market	225,000	225,000
Inventories (note 2)	24,545,000	23,791,000
Deposits and prepaid expenses	416,000	238,000
	38,022,000	31,558,000
OTHER RECEIVABLES	130,000	363,000
INVESTMENTS (note 3)	2,892,000	2,084,000
FIXED ASSETS, at cost		
Land	1,348,000	1,348,000
Buildings	2,930,000	2,722,000
Machinery, equipment, fixtures and leasehold improvements	12,902,000	11,814,000
	17,180,000	15,884,000
Less accumulated depreciation	6,666,000	5,880,000
	10,514,000	10,004,000
EXCESS OF COST OF SHARES OVER UNDERLYING BOOK VALUE OF SUBSIDIARY AT DATE OF ACQUISITION, less amortization (note 1(d))	5,431,000	5,573,000
	$56,989,000	$49,582,000

Approved by the Board

JOHN B. RIDLEY, *Director*

G. R. CHATER, *Director*

	January 31, 1976	1975
LIABILITIES		
CURRENT LIABILITIES		
Bank advances		$ 4,364,000
Accounts payable and accrued liabilities	$13,676,000	8,278,000
Income and other taxes payable	3,296,000	3,793,000
Principal due within one year on long term debt	1,202,000	412,000
	18,174,000	16,847,000
LONG TERM DEBT (note 4)	10,679,000	11,936,000
DEFERRED INCOME TAXES	442,000	355,000
PREFERENCE SHARES HELD BY MINORITY SHAREHOLDERS in subsidiary companies (note 5)	1,413,000	1,631,000
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (note 6)		
Authorized		
3,500,000 Common shares without par value		
Issued		
1,893,930 Common shares (1975, 1,890,582 shares)	7,143,000	7,055,000
CONTRIBUTED SURPLUS (note 5)	156,000	172,000
RETAINED EARNINGS	18,982,000	11,586,000
	26,281,000	18,813,000
	$56,989,000	$49,582,000

Long term leases (note 8)
Contingent liabilities (note 9)

Consolidated Statement of Changes in Financial Position

GRAFTON GROUP LIMITED
and subsidiary companies

	Year Ended January 31, 1976	1975
WORKING CAPITAL DERIVED FROM		
Operations		
Net income for the year	$ 8,531,000	$ 5,180,000
Items not involving working capital		
Depreciation	1,320,000	945,000
Deferred income taxes	87,000	83,000
Provision for decline in value of investments		234,000
Amortization of excess of cost of shares over underlying book value of subsidiary	142,000	71,000
Gain on sale of fixed assets		(200,000)
Equity in earnings of investments	(569,000)	(308,000)
	9,511,000	6,005,000
Repayment of note and advance receivable from an affiliated company		904,000
Proceeds from sale of fixed assets	9,000	405,000
Proceeds from issue of common shares	88,000	37,000
Issue of 7¼% convertible debentures upon acquisition of subsidiary		5,181,000
Term bank loan arranged upon acquisition of subsidiary		4,249,000
Decrease in other receivables	233,000	
	9,841,000	16,781,000
WORKING CAPITAL APPLIED TO		
Additions to fixed assets	2,026,000	1,476,000
Increase in other receivables		194,000
Dividends on common shares	1,135,000	963,000
Cost of preference shares of Grafton-Fraser Limited purchased for cancellation	234,000	264,000
Reduction of non-current portion of long term debt	1,257,000	401,000
Acquisition of subsidiary less its working capital of $3,233,000		6,462,000
Acquisition of the net assets and operations of the division of an affiliated company less its working capital of $1,586,000		243,000
Investment in 50% owned partnership interest net of fixed assets of $187,000 transferred to partnership at fair market value	52,000	
	4,704,000	10,003,000
INCREASE IN WORKING CAPITAL	5,137,000	6,778,000
WORKING CAPITAL AT BEGINNING OF YEAR	14,711,000	7,933,000
WORKING CAPITAL AT END OF YEAR	$19,848,000	$14,711,000

Consolidated Statement of Changes in Financial Position and Notes to Consolidated Financial Statements

GRAFTON GROUP LIMITED
and subsidiary companies

Components of increase in working capital		
Increase in current assets		
Cash and bank deposit receipts	$ 5,279,000	$ 832,000
Accounts receivable	253,000	1,121,000
Marketable securities		11,000
Inventories	754,000	12,352,000
Deposits and prepaid expenses	178,000	70,000
	6,464,000	14,386,000
Increase (decrease) in current liabilities		
Bank advances	(4,364,000)	4,364,000
Accounts payable and accrued liabilities	5,398,000	2,538,000
Income and other taxes payable	(497,000)	401,000
Principal due within one year on long term debt	790,000	305,000
	1,327,000	7,608,000
Increase in working capital	$ 5,137,000	$ 6,778,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiary companies since dates of acquisition. The major operating subsidiaries are as follows:

	Fiscal Year End	Year of Acquisition
Grafton-Fraser Limited	January 7, 1976	1967
Toby Industries Limited	December 31, 1975	1969
Grafton Realty Company, Limited	December 31, 1975	1971
Maher Shoes Limited	January 3, 1976	1974

Maher Shoes Limited has been included in the comparative 1975 figures from July 1, 1974, the effective date of acquisition.

(b) Inventories

The inventories (note 2) are valued on the following basis:
Retail inventory — lower of cost and net realizable value less normal profit margin.
Manufacturing inventory
Raw materials — lower of cost and replacement cost.
Work in process and finished goods — lower of cost and net realizable value.

(c) Fixed Assets

Depreciation is provided as follows:

Buildings	— 2½ % diminishing balance
Machinery, equipment and fixtures	— 20% diminishing balance and 10% straight-line
Leasehold improvements	— term of lease, straight-line

(d) Excess of Cost of Shares over Underlying Book Value of Subsidiary at Date of Acquisition

The excess of cost over underlying book value of Maher Shoes Limited acquired during the 1975 fiscal year is being amortized on a straight-line basis over forty years from the date of acquisition. Accumulated amortization to January 31, 1976 is $213,000.

(e) Income Taxes

The company charges earnings with income taxes currently payable and also with income taxes deferred by claiming certain costs for income tax purposes in excess of related costs charged to income. The accumulated total of such income tax deferments is reflected in the consolidated balance sheet as "Deferred income taxes".

2. INVENTORIES

	1976	1975
Retail		
Apparel	$14,005,000	$12,000,000
Footwear	7,560,000	8,369,000
	21,565,000	20,369,000
Manufacturing		
Raw materials	1,415,000	1,757,000
Work in process	197,000	242,000
Finished goods	1,368,000	1,423,000
	2,980,000	3,422,000
	$24,545,000	$23,791,000

3. INVESTMENTS

	1976	1975
Forsyth Trading Company Limited		
Redeemable preference shares, at cost	$ 1,000,000	$ 1,000,000
Common shares, 33⅓% interest, at equity	871,000	320,000
	1,871,000	1,320,000
Barcley-Lanes Shoes — 50% interest, at equity	257,000	
Listed marketable securities, at cost less provision for decline in value of $234,000 recorded in 1975 (market value 1976, $1,243,000; 1975, $661,000)	764,000	764,000
	$ 2,892,000	$ 2,084,000

Barcley-Lanes Shoes is a partnership formed during the year, 50% of which is owned by Maher Shoes Limited, a subsidiary company. The company's share of the earnings of the partnership, which operates retail shoe stores, has been included in these financial statements on an equity basis.

4. LONG TERM DEBT

The long term debt comprises the following:	1976	1975
(a) 7¼% Convertible debentures, maturing June 30, 1979	$ 5,072,000	$ 5,125,000
(b) Term bank loan, bearing interest at the prime banking rate plus 1% maturing September 1, 1979	4,000,000	4,249,000
(c) Term bank loan, bearing interest at the prime banking rate plus 1¾% (not less than 8½% per annum) maturing May 1, 1982	1,534,000	1,649,000
(d) 6¾% Sinking fund debentures, Series A, maturing April 1, 1987	1,275,000	1,325,000
	11,881,000	12,348,000
Less principal due within one year	1,202,000	412,000
	$10,679,000	$11,936,000

(a) The 7¼% convertible debentures of Grafton Group Limited have been issued in individual units of $50. The debentures are convertible at the holder's option into common shares of Grafton Group Limited at a conversion price of $30 per common share, and cash or scrip certificates for the balance.

The debentures may be redeemed by the company prior to June 30, 1979 if the weighted average trading price per common share, on a stock exchange, of Grafton Group is $36 or greater for each of 20 successive trading days, at which time the company may call the debentures for redemption on thirty days notice.

The debentures are secured by a first fixed and specific pledge on notes payable by Grafton-Fraser Limited to the company ($5,181,000 at January 31, 1976). These notes are secured by the pledge of 109,200 common shares of Maher Shoes Limited.

(b) A term bank loan of Grafton-Fraser Limited amounting to $4,000,000 is secured by the pledge of 98,055 common shares of Maher Shoes Limited and is repayable by annual amounts of $1,000,000 on September 1, 1976 to 1979 inclusive.

(c) A term bank loan of Grafton Realty Company, Limited amounting to $1,534,000 is secured by a demand debenture in the amount of $1,950,000 on all the assets of Grafton Realty Company, Limited and is repayable in equal monthly instalments of $25,000 (principal and interest) maturing May 1, 1982, at which point the unpaid principal balance becomes due.

(d) The debentures of Maher Shoes Limited are secured by a first floating charge on the assets of Maher Shoes Limited. The more significant of the covenants of the trust deed restrict the subsidiary company, Maher Shoes Limited, from reducing its consolidated working capital below $1,000,000 and from paying dividends on common shares if such payments would reduce consolidated working capital (which was $3,848,000 at January 3, 1976) below $1,250,000. At January 3, 1976, the company had a sinking fund credit sufficient to meet $4,000 of the $76,000 payment due in 1977 and the payments required in 1977 and future years average approximately $106,000 per annum to 1987, the date of maturity.

Principal repayments within the next five fiscal years on all long term debt of Grafton Group Limited and subsidiary companies are approximately:

1977	$ 1,202,000
1978	1,226,000
1979	1,249,000
1980	6,346,000
1981	302,000
	10,325,000
due beyond 1981	1,556,000
	$11,881,000

5. PREFERENCE SHARES HELD BY MINORITY SHAREHOLDERS IN SUBSIDIARY COMPANIES

	1976	1975
Maher Shoes Limited 60¢ Cumulative, non-redeemable preference shares without par value	$ 1,413,000	$ 1,413,000
Grafton-Fraser Limited 6% Cumulative preference shares par value $20, redeemable at $21		218,000
	$ 1,413,000	$ 1,631,000

During the year, Grafton-Fraser Limited called the balance of its preference shares for redemption. The $16,000 premium paid on redemption has been charged to contributed surplus.

6. CAPITAL STOCK

	1976	1975
Common shares		
Issued	Consideration	
Issued during the year under the Employee Stock Option Plan, 1,580 shares (1975, 1,550 shares) at $21.60	$ 35,000	$ 33,000
Issued under the terms of the 7¼% convertible debentures, 1,768 shares (1975, 125 shares)	53,000	4,000
	$ 88,000	$ 37,000
Shares set aside for Employee Stock Option Plan	Shares	
Reserved for allotment	51,850	51,850
Options outstanding, exercisable at $21.60 per share up to February 11, 1977	23,716	25,296
Options exercised to date	19,434	17,854
	95,000	95,000

In addition, 170,797 common shares have been set aside for conversion privileges attached to the 7¼% convertible debentures.

7. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding during the year (1,892,260 shares in 1976 and 1,889,745 shares in 1975).

Fully diluted earnings per share illustrates the effect on earnings of the conversion of the outstanding 7¼% convertible debentures.

8. LONG TERM LEASES

The aggregate amount of rentals incurred by all of the company's subsidiaries as an expense during their most recent fiscal periods in respect of all leases including licences was $11,541,000.

Based upon all leases including licences in existence as at their fiscal period ends, the aggregate minimum annual amount that will be incurred by all the company's subsidiaries as rental or licence expense during their next five fiscal years is approximately $6,687,000.

9. CONTINGENT LIABILITIES

With respect to the investment in shares of Forsyth Trading Company Limited (note 3), Grafton Group Limited has guaranteed 50% of Forsyth's bank loans and certain notes payable by Forsyth. Grafton Group Limited's contingent liability at January 1, 1976 amounted to $1,165,000 (1975, $1,900,000) and the maximum contingent liability under these guarantees is limited to $2,730,000.

10. PENSION PLAN

Current pension costs are charged to operations each year. At January 3, 1976 a subsidiary company, Maher Shoes Limited, had a present value obligation for unfunded past service pension plan costs of approximately $450,000 based on the most recent actuarial calculation. These past service costs are being expensed over fourteen years.

11. ANTI-INFLATION LEGISLATION

The company and its subsidiaries are subject to the Anti-Inflation Act which provides, from October 14, 1975 for the restraint of profit margins, prices, dividends and compensation. The provisions of this Act should have no significant effect on the company's consolidated earnings for the year ended January 31, 1976.

At the present time, the maximum dividend rate allowable in the twelve months ending October 13, 1976 under the Anti-Inflation legislation is 68¢ per share.

12. OTHER STATUTORY INFORMATION

Remuneration of directors and senior officers (as defined by The Business Corporations Act) was $523,000 (1975, $432,000).

Auditors' Report

To the Shareholders of
Grafton Group Limited

We have examined the consolidated balance sheet of Grafton Group Limited and subsidiary companies as at January 31, 1976 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at January 31, 1976 and the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell & Co.

Chartered Accountants

Toronto, Canada
March 3, 1976

Statistics

	January 31					
	1976	1975	1974	1973	1972	1971
	Omitting 000's					
SALES PER QUARTER						
1st Quarter	$ 23,379	$ 15,184	$ 11,867	$ 10,034	$ 8,211	$ 7,358
2nd Quarter	32,457	21,800	16,894	14,141	11,764	10,208
3rd Quarter	33,671	27,933	15,882	13,847	11,474	9,424
4th Quarter	49,741	39,672	26,621	21,577	17,433	15,014
Total	$139,248	$104,589	$ 71,264	$ 59,599	$ 48,882	$ 42,004

	January 31					
	1976	1975	1974	1973	1972	1971
	Omitting 000's					
NET INCOME PER QUARTER						
1st Quarter	$ 718	$ 633	$ 434	$ 301	$ 189	$ 125
2nd Quarter	1,576	1,131	808	651	517	378
3rd Quarter	1,718	804	595	502	361	200
4th Quarter	4,519	2,612	2,197	1,779	1,192	935
Total	$ 8,531	$ 5,180	$ 4,034	$ 3,233	$ 2,259	$ 1,638

	January 31					
	1976	1975	1974	1973	1972	1971
EARNINGS PER SHARE PER QUARTER						
1st Quarter	$ .38	$ .335	$ .231	$ .161	$ .100	$ .066
2nd Quarter	.833	.597	.425	.347	.277	.202
3rd Quarter	.91	.426	.315	.268	.193	.107
4th Quarter	2.387	1.382	1.169	.944	.650	.635
Total	$ 4.51	$ 2.74	$ 2.14	$ 1.72	$ 1.22	$ 1.01

	1975	1974	1973	1972	1971
FIVE YEAR RECORD OF STOCK PRICES					
High	32	28¼	42	42	20¾
Low	20⅝	17	21	20	14⅜

VALUATION DAY SHARE PRICES: For capital gains tax purposes, some shareholders may need to know the value of their shares on Valuation Day. The December 22, 1971, Valuation Day value, as established by the Department of National Revenue was $20.75.

	January 31								
	1976	1975	1974	1973	1972	1971	1970	1969	1968
	Omitting 000's								
Sales — Apparel	$ 98,742	$ 78,846	$ 65,718	$ 54,415	$ 44,280	$ 37,895	$ 32,038	$ 25,219	$ 21,461
— Footwear	29,359	15,285							
Total Retail	128,101	94,131	65,718	54,415	44,280	37,895	32,038	25,219	21,461
Homefurnishings	11,147	10,458	5,545	5,184	4,602	4,109	4,115		
	139,248	104,589	71,263	59,599	48,882	42,004	36,153	25,219	21,461
Cost of sales and expenses other than undernoted	119,522	91,200	61,782	52,651	43,741	37,749	32,950	23,399	20,602
	19,726	13,389	9,481	6,948	5,141	4,255	3,203	1,820	859
Income from investments	611	341					27		
Gain on sale of fixed assets		200							
Income before taking into account the undernoted items	20,337	13,930	9,481	6,948	5,141	4,255	3,230	1,820	859
Percent to sales	14.6	13.3	13.3	11.7	10.5	10.1	8.9	7.2	4.0
Depreciation	1,320	945	567	393	267	196	161	100	109
Interest on long term debt	1,144	764	172	112					
Other interest (net)	676	781	275	101	119	356	360	255	263
Amortization of goodwill	142	71							
Provision for decline in value of securities and investments		359	87						
	3,282	2,920	1,101	606	386	552	521	355	372
Income before income taxes and minority shareholders' interest	17,055	11,010	8,380	6,342	4,755	3,703	2,709	1,465	487
Income taxes	8,427	5,763	4,310	3,067	2,445	2,009	1,461	789	253
Income before minority shareholders' interest	8,628	5,247	4,070	3,275	2,310	1,694	1,248	676	234
Preference share dividends paid to minority shareholders of subsidiary companies	97	67	36	42	51	56	54	54	47
Common shares since acquired by Grafton Group Limited							164		
NET INCOME FOR THE YEAR	$ 8,531	$ 5,180	$ 4,034	$ 3,233	$ 2,259	$ 1,638	$ 1,030	$ 622	$ 187
Earnings per Common Share Basic	$ 4.51	$ 2.74	$ 2.14	$ 1.72	$ 1.22	$ 1.01	$ .69	$ .58	$ .18
Fully diluted	$ 4.22	$ 2.67							
Dividends per common share	$ .60	$ .51	$ .42	$ .325	$ .20	$ .05			
% of diluted earnings per common share	14.2	19.1	19.6	18.9	16.4	5.0			
Weighted average number of shares outstanding	1,892,260	1,889,745	1,883,600	1,874,700	1,853,667	1,611,496	1,611,496	1,096,750	1,096,750

Historical Balance Sheets

ASSETS	January 31					
	1976	1975	1974	1973	1972	1971
	Omitting 000's					
CURRENT ASSETS						
Cash and bank deposit receipts	$ 8,391	$ 3,112	$ 2,280	$ 2,444	$ 2,079	$ 14
Accounts receivable	4,445	4,192	3,071	2,676	2,051	1,878
Marketable securities, at the lower of cost and market	225	225	214	355	230	
Inventories	24,545	23,791	11,440	8,601	6,519	5,845
Deposits and prepaid expenses	416	238	168	282	584	100
	38,022	31,558	17,173	14,358	11,463	7,837
OTHER RECEIVABLES	130	363	1,007	1,013	874	797
INVESTMENTS	2,892	2,084	2,009			
FIXED ASSETS, AT COST						
Land	1,348	1,348	1,390	1,390	413	
Buildings	2,930	2,722	2,754	2,949	668	
Machinery, equipment, fixtures and leasehold improvements	12,902	11,814	4,803	3,979	3,759	3,178
	17,180	15,884	8,947	8,318	4,840	3,178
Less accumulated depreciation	6,666	5,880	3,148	2,925	2,619	1,920
	10,514	10,004	5,799	5,393	2,221	1,258
EXCESS OF COST OF SHARES OVER BOOK VALUE	5,431	5,573				
	$56,989	$49,582	$25,988	$20,764	$14,558	$ 9,892
LIABILITIES						
CURRENT LIABILITIES						
Bank advances		$ 4,364				$ 275
Accounts payable and accrued liabilities	$13,676	8,278	$ 5,741	$ 6,106	$ 4,001	3,098
Income and other taxes payable	3,296	3,793	3,392	965	671	1,071
Notes payable					740	
Principal due within one year on long term debt	1,202	412	107	147		
	18,174	16,847	9,240	7,218	5,412	4,444
LONG TERM DEBT	10,679	11,936	1,628	1,720		190
DEFERRED INCOME TAXES	442	355	79	73	41	37
PREFERENCE SHARES HELD BY MINORITY SHAREHOLDERS	1,413	1,631	479	662	788	907
SHAREHOLDERS' EQUITY						
CAPITAL STOCK						
Authorized						
6% Preference Shares with a par value of $10						
Common Shares without par value						
Issued						
Preference Shares						482
Common Shares	7,143	7,055	7,018	6,790	6,666	4,042
CONTRIBUTED SURPLUS	156	172	175	175	167	149
RETAINED EARNINGS (deficit)	18,982	11,586	7,369	4,126	1,484	(359)
	26,281	18,813	14,562	11,091	8,317	4,314
	$56,989	$49,582	$25,988	$20,764	$14,558	$ 9,892
WORKING CAPITAL	$19,848	$14,711	$ 7,933	$ 7,140	$ 6,051	$ 3,393

Store Statistics

	January 31								
	1976	1975	1974	1973	1972	1971	1970	1969	1968
NUMBER OF BRANCHES									
Apparel Division									
Leased Woolco Departments	79	72	67	56	47	41	33	27	22
Company Stores	79	72	65	54	51	46	41	39	40
Total	158	144	132	110	98	87	74	66	62
Footwear Division	203	217	210	183	176	169	161	155	129
BRANCHES OPENED									
Apparel Division	16	15	24	16	13	14	10	6	5
Footwear Division	14	24	41	20	16	19	14	29	1
BRANCHES CLOSED									
Apparel Division	2	3	2	4	2	1	2	2	1
Footwear Division	28	17	14	13	9	11	8	3	1
STORE SPACE AT END OF YEAR, omitting 000's									
Apparel Division	1,005	912	850	718	633	579	488	424	377
Footwear Division	364	398	398	347	341	336	311	302	249
SALES PER SQUARE FOOT based on year end space									
Apparel Division	$98.2	$86.5	$77.3	$75.8	$69.9	$65.4	$65.6	$59.5	$56.9
Footwear Division	$79.6	$67.8	$60.6	$57.0	$48.1	$46.2	$46.4	$44.8	$45.9

	Apparel Division				Footwear Division	
	Leased Woolco Depts.		Company Stores			
SALES BY REGION	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales
British Columbia	4	5.3	9	9.2	39	22.4
Alberta	9	16.1	3	4.8	4	2.1
The Prairies	9	12.1	4	4.4	3	1.2
Ontario	28	35.5	56	75.8	138	65.4
Quebec and Maritimes	29	31.0	7	5.8	19	8.9
Total	79	100.0	79	100.0	203	100.0

Specific list of store locations on request.

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GRAFTON GROUP
LIMITED

Established 1853

INTERIM REPORT

for the

SIX MONTHS ENDED JULY 31, 1976

HIGHLIGHTS

FIRST HALF RESULTS

	Omitting 000's 1976	1975	% Change
Sales	$65,986	$55,836	+ 18.0
Income	$ 2,325	$ 2,294	+ 1.4
Earnings per Common Share			
Basic	$ 1.23	$ 1.21	+ 1.6
Fully Diluted	$ 1.18	$ 1.16	+ 1.7

SECOND QUARTER RESULTS

	1976	1975	% Change
Sales	$37,689	$32,457	+ 16.1
Income	$ 1,449	$ 1,576	− 8.1
Earnings per Common Share			
Basic	$ .76	$ .83	− 8.4
Fully Diluted	$ .72	$ .79	− 8.9

(Unaudited)

TO OUR SHAREHOLDERS:

The Company reports increased sales of 18% for the six months, and slightly reduced earnings for the second quarter of the year.

Our dominant source of income is Grafton-Fraser Limited, apparel retailing, and in the second quarter while our Jack Fraser stores have performed well, our leased store division failed to achieve what was, in retrospect, an overly optimistic sales plan, notwithstanding substantial markdowns and vastly increased promotional activity. The division's strategy was established as a result of the October, 1975 A.I.B. guidelines as being the only allowable manner in which earnings per share could be increased. Furthermore, increased expenses were planned as part of this aggressive sales drive, and the consequent shortfall of sales to plan increased some variable expenses abnormally as a percentage of sales.

Terminal markdowns, in the month of July, have been heavy on all Spring and Summer goods, and while the operating period on which we are reporting ended June 30, adequate markdown reserve provisions had been set up out of previous earnings to provide for these July markdowns. The weather was quite unfavourable throughout the Spring, and the results are being compared with a period a year ago when the weather was unusually fine and overall conditions worked in an almost perfect manner to achieve maximum sales, maximum replenishment, minimum markdowns and a sellout of seasonal inventory.

Maher Shoes, our retail Footwear Division, reports a loss for the six months as compared with a modest profit for the six months a year ago. Most of the variance is in the results of its Western Canada division which is sharply down in earnings from excellent results a year ago, due to relatively poor sales in British Columbia.

Toby Industries, our Home Furnishings Division, enjoyed a modest six month period, with a sharp slump in the second quarter sales. This period was used to keep factories busy by pre-manufacturing Fall finished goods. The order backlog is now somewhat ahead of this time a year ago, and it is likely the year as a whole will be improved modestly.

Total investment income is up, although that portion received from the equity earnings in Forsyth Trading is down slightly due to the 85% A.I.B. regulations.

Sales in the third quarter commencing in July to date are below expectations. The anticipation for the rest of the year is for less buoyant spending by consumers and a great urgency on our part to return our Woolco Division to its previously ordered pattern, and achieve the best possible results under prevailing circumstances from all other divisions. Retail inventory to sales comparative ratios as of June 30, the end of the operating period on which we are reporting, other than Fall goods in transit, and before terminal seasonal markdowns, were:

	Sales	Inventory
Total Retail	+ 19.3%	+ 18.2%
Woolco Divison	+ 22.5%	+ 34.9%
Jack Fraser Division	+ 22.5%	+ 5.8%
Maher Division	+ 9.5%	+ 11.1%

An extra dividend of 3¢ a share has been declared payable September 15th and the regular quarterly dividend has been increased 1¢ to 18¢. This provides for the maximum payout in the period ending October 15, 1976 and the period ending October 15, 1977 under the A.I.B. regulations as currently stated.

We earnestly support the need to control inflation, but we strongly disagree with the design, implementation and communication of the variable policies of the A.I.B. which have caused a demoralizing effect on the industry and a great strain on our management resources.

Toronto, September 3, 1976

G. R. CHATER,
President

GRAFTON GROUP LIMITED

CONSOLIDATED STATEMENT OF EARNINGS

	SECOND QUARTER Omitting 000's 1976	1975	% Change	SIX MONTH PERIOD ENDED JULY 31 Omitting 000's 1976	1975	% Change
Sales						
Retail Division						
Apparel	$27,016	$22,452	+ 20.3	$46,765	$38,180	+ 22.5
Footwear	8,153	7,155	+ 13.9	13,786	12,588	+ 9.5
	35,169	29,607	+ 18.8	60,551	50,768	+ 19.3
Homefurnishings	2,520	2,850	– 11.6	5,435	5,068	+ 7.2
Total Sales	37,689	32,457	+ 16.1	65,986	55,836	+ 18.2
Income from operations before taking into account the undernoted items	3,403	3,670	– 7.3	5,937	5,970	– .6
Deduct						
Depreciation	(361)	(317)	+ 13.9	(711)	(629)	+ 13.0
Interest and bank charges (net)	(515)	(558)	– 7.7	(844)	(971)	– 13.1
Amortization of excess of cost of shares over underlying book value of subsidiary at date of acquisition	(35)	(35)		(71)	(71)	
Add						
Equity in earnings of corporate joint venture	228	252	– 9.5	228	252	– 9.5
	(683)	(658)	+ 3.7	(1,398)	(1,419)	– 1.5
Income before income taxes and minority shareholders' interest	2,720	3,012	– 9.7	4,539	4,551	– .3
Income taxes	1,247	1,412	– 11.7	2,167	2,206	– 1.8
Income before minority shareholders' interest	1,473	1,600	– 7.9	2,372	2,345	+ 1.2
Preference share dividends paid to minority shareholders of subsidiary companies	24	24		47	51	– 7.8
Net income for the period	$ 1,449	$ 1,576	– 8.1	$ 2,325	$ 2,294	+ 1.4
Earnings per share						
Basic	$ .76	$ .83		$ 1.23	$ 1.21	
Fully diluted	$ .72	$ .79		$ 1.18	$ 1.16	

(Unaudited)

GRAFTON GROUP LIMITE

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

SIX MONTH PERIOD ENDED JULY 31, 1976
(With Comparative Figures for 1975)

	Omitting 000's 1976	1975
Working capital derived from		
Operations		
Net income for period	$ 2,325	$ 2,294
Items not involving working capital		
Depreciation	711	629
Amortization of excess of cost of shares over underlying book value of subsidiary	71	71
Equity income in corporate joint venture	(228)	(252)
	2,879	2,742
Proceeds from issue of common shares	77	18
Repayment of note receivable	36	204
	$ 2,992	$ 2,964
Working capital applied to		
Additions to fixed assets	$ 1,044	$ 561
Increase in investments		235
Dividends on common shares	606	567
Cost of preference shares purchased for cancellation		216
Reduction of long term debt	178	61
	$ 1,828	$ 1,640
Increase in working capital	1,164	1,324
Working capital at beginning of period	19,848	14,711
Working capital at end of period	$21,012	$16,035

(Unaudited)